1985 ANNUAL REPORT

INTERCO

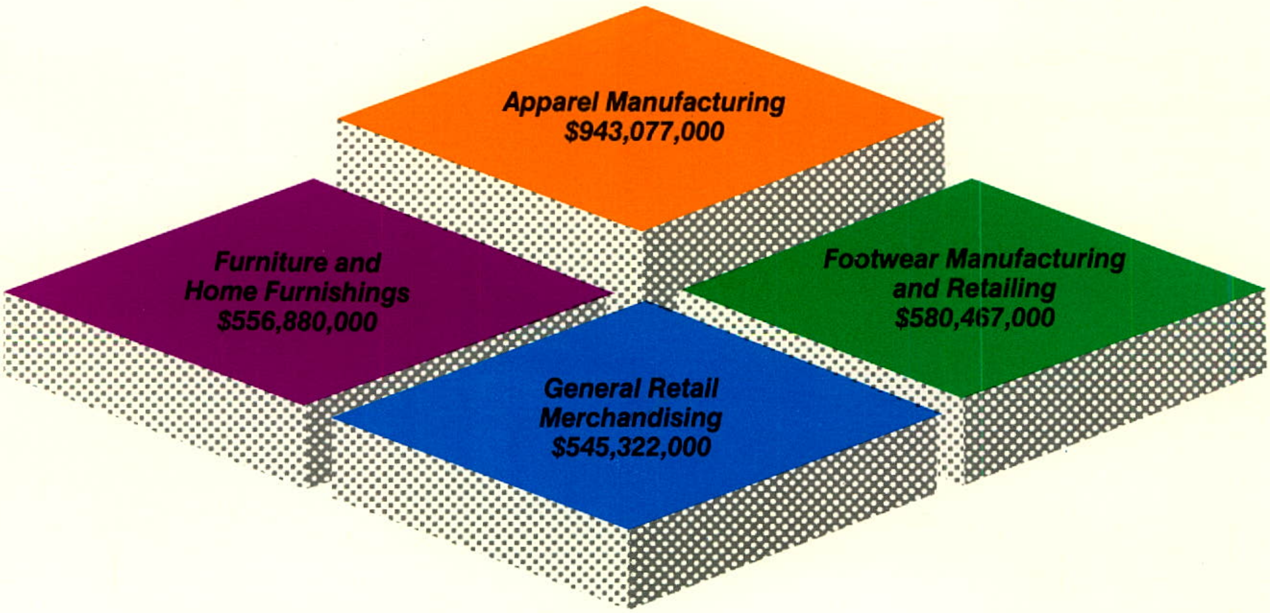
LEADERSHIP IN CONSUMER PRODUCTS AND SERVICES

Contents

Highlights

Years Ended	February 28, 1985	February 29, 1984	Change
From operations:			
Net sales	**$2,625,746,000**	$2,678,886,000	(2.0)%
Net earnings before asset redeployment expense	**92,163,000**	116,194,000	(20.7)%
As a percent of sales	**3.5%**	4.3%	
Net earnings	**72,163,000**	116,194,000	(37.9)%
As a percent of sales	**2.7%**	4.3%	
Per share of common stock:			
Net earnings before asset redeployment expense	**$ 5.68**	$7.02	(19.1)%
Asset redeployment expense	**$(1.23)**	$ —	
Net earnings	**$ 4.45**	$7.02	(36.6)%
Dividends	**$ 3.03**	$2.88	5.2 %
Financial condition at year end:			
Working capital	**$ 781,333,000**	$ 852,847,000	(8.4)%
Current ratio	**4.2 to 1**	4.2 to 1	
Total assets	**1,535,241,000**	1,607,832,000	(4.5)%
Shareholders' equity	**1,064,764,000**	1,100,963,000	(3.3)%
Book value per common share	**$70.43**	$68.82	2.3 %
Shares outstanding at year end:			
Common	**14,076,610**	14,832,859	
Preferred	**733,037**	802,085	
Number of shareholders	**11,500**	12,300	
Number of employees	**48,000**	51,000	

Contribution of Sales by Operating Group



To Our Shareholders

INTERCO's fiscal year 1985 began on a strong note, with both sales and earnings in the first quarter ahead of the prior year. However, midway through the second quarter, consumer spending slowed noticeably, leading to an industry-wide buildup of retail inventories, particularly in apparel and footwear products. This resulted in a high level of promotions and discounting, at both retail and wholesale, in most of the market sectors served by the INTERCO companies, and adversely affected the year's financial results.

Despite the earnings decline, it was a year of transition and one of substantial change and progress for INTERCO. Management's conscious decision to focus on long-term, versus short-term, performance resulted in the acceleration of the company's asset redeployment program. To cover the estimated costs and expenses associated with this program, a nonrecurring charge totalling $20 million after tax, or $1.23 per share, was made in the third quarter of fiscal 1985.

Although net sales declined 2.0 percent during the past year, sales for those operations not affected by the asset redeployment program were up 3.2 percent on a comparable basis over last year. Earnings per share before the nonrecurring charge were $5.68 compared with $7.02 in the prior year. Earnings per share after the nonrecurring charge were $4.45. A detailed review of the company's financial performance over the past three years is provided later in this Annual Report to Shareholders.

INTERCO is a consumer products and services company with operations in four industry groups: apparel manufacturing, general retailing, footwear manufacturing and retailing, and furniture and home furnishings. While some of the operating companies within each group may have different characteristics, all are directed toward serving the consumer market.

INTERCO's long-term corporate planning process is in turn directed toward achieving objectives shared by each of these consumer businesses:

- increased return on corporate assets,
- long-term growth in sales and earnings, and
- improved return on shareholders' investment.

Central to achieving these objectives is the market leadership which INTERCO's operating companies are able to provide within their respective industries. The asset redeployment program, which was initiated in fiscal 1984 and accelerated during the past year, is designed to concentrate resources in those areas where opportunity for market leadership offers appropriate long-term growth potential and commensurate improvement in profitability and return on shareholders' investment.

Several key themes are dominant in most of our businesses. First, as previously noted, they are leading companies within their respective markets. Second, they have continually placed great emphasis on improving return on assets through productivity and cost-control programs, while striving to offer better products and value to the consumer. Finally, these businesses are thoroughly aware of the markets and changing conditions in which they operate, and they are able to innovate as well as to respond in providing the consumer with better products and services.

Strategic planning is vital to maintaining market leadership. Although each operating company remains free to experiment with new products, manufacturing and marketing innovations, each company must also meet specific criteria for return on assets and return on investment. Similar guidelines are used for evaluating new business opportunities as well as possible divestitures.

While INTERCO's Apparel Manufacturing Group was impacted by soft market conditions, there were a number of significant accomplishments. The new collections by *Queen Casuals* and *Devon* serving the career woman, and the recent introduction of outerwear for men and women under the *Winning Edge* label by *Londontown* are noteworthy examples. Several of the men's apparel companies enjoyed improved results during the past year. Late in fiscal 1985, the assets related to the *Sidney Gould* manufacturing and distribution operations were divested. Its trademarks and labels were retained for licensing to others.

The General Retail Merchandising Group was the principal focus of the company's asset redeployment program. During the second half of the year, the 63-unit *Alberts* specialty retail operation and *Eagle Family Discount Stores,* consisting of 206 stores and related assets, were sold. Remaining *P.N. Hirsch* units in the Northwest and Texas, which were not divested in fiscal 1984, were consolidated into the *Idaho Department Stores* division.

Footwear operations were affected by the problems encountered by the shoe industry as a whole—a slowdown in consumer spending and excessive inventories at the retail level. Nevertheless, INTERCO's market leadership in serving the quality-oriented consumer enabled our Footwear Manufacturing and Retailing Group to outperform many other companies in the industry.

INTERCO has developed a leading position in the furniture industry through *Ethan Allen* and *Broyhill* which comprise the Furniture and Home Furnishings Group. As part of their long-term growth plans, *Ethan Allen* completed the construction of a new recliner manufacturing facility in North Carolina and *Broyhill* continued to expand its Gallery program. During the past year, the softening economy, start-up costs associated with new product lines and shorter manufacturing production runs contributed to the group's decline in operating earnings, compared with record results a year ago.

The company's financial condition and cash flow continued strong during the year. In June, the common stock dividend was increased 6.9 percent to an annual rate of $3.08 per share. Also, the company announced its intention to purchase up to one million shares of its common stock and at year-end over 960,000 shares had been repurchased. At February 28, 1985, the company's financial condition was solid with a working capital ratio of 4.2 to 1, and a debt-to-capitalization ratio of 15.5 percent. During fiscal 1985, capital expenditures increased 14.3 percent to $58.4 million.

The past year was one of repositioning. Both acquisitions and divestitures are important in pursuing long-term sales and earnings growth, an increased return on assets and improved return on shareholders' equity. In addition to the previously discussed divestitures, on March 15, 1984, INTERCO acquired *Abe Schrader Corporation*, a leading designer and manufacturer of women's apparel. This acquisition provided outstanding brand names serving markets not previously covered by the apparel group.

INTERCO remains committed to internal growth in its divisions while continuing to explore acquisitions which will enhance market leadership. The company also remains vigilant to major new business opportunities where it may immediately or rapidly become an industry leader.

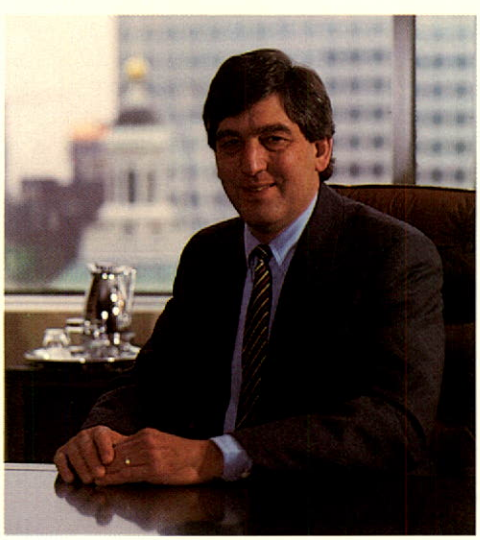
On behalf of INTERCO's Board of Directors and Management, we wish to acknowledge gratefully the continuing support of our customers, employees and shareholders during the past year.

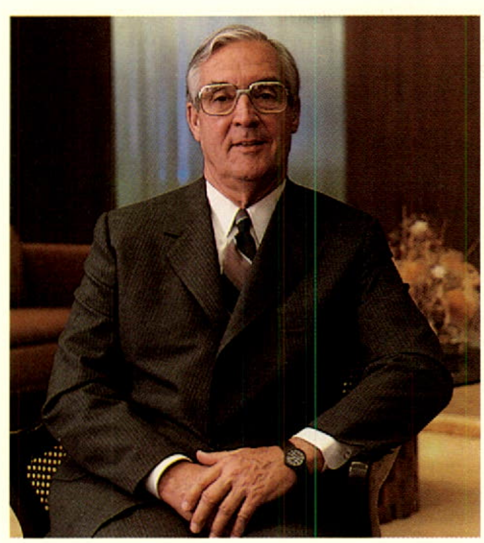
We look forward to the new year as one of both challenge and opportunity in terms of increased growth, profitability and market leadership for the company.

Harvey Saligman
President and Chief
Executive Officer

John K. Riedy
Chairman of the Board

April 8, 1985





INTERCO Today

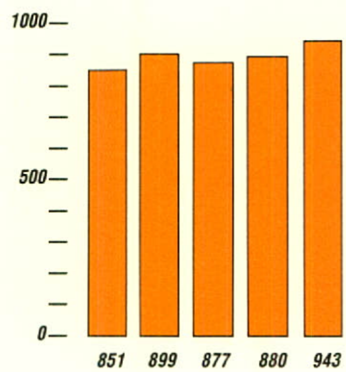
INTERCO is a broadly based major manufacturer and retailer of consumer products and services represented by four operating groups.

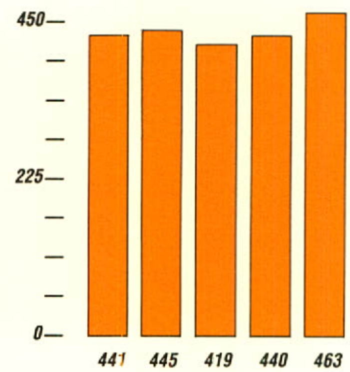
Net Sales
(In Millions)

Identifiable Assets
(In Millions)

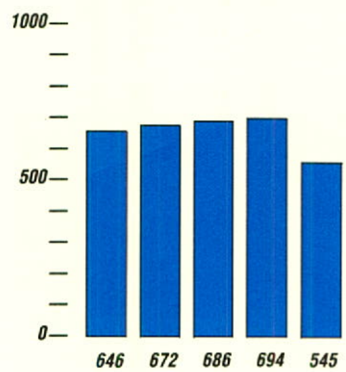
1981 1982 1983 1984 1985

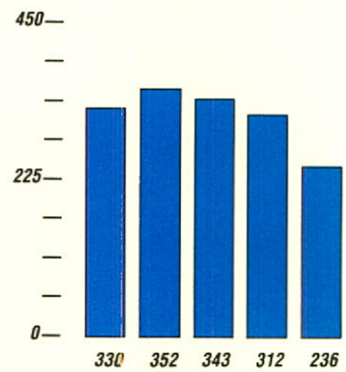
Apparel Manufacturing Group consists of 11 apparel companies operating 51 manufacturing plants and 12 major distribution centers across the country. The group designs, manufactures and distributes a full range of branded and private-label sportswear, casual apparel, outer garments and headwear for men and women. Distribution is national in scope to department stores, specialty shops and other retail units. Substantial distribution, under private and branded labels, is also made to large national retail and discount chains.



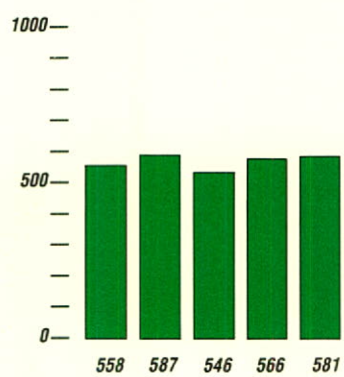


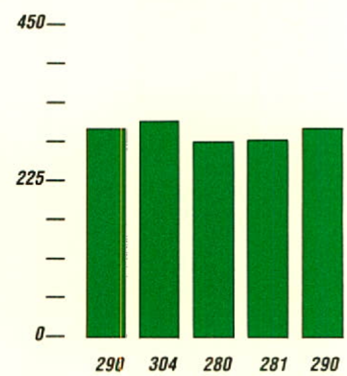
General Retail Merchandising Group operates 263 retail locations in 24 states offering to the consumer a large assortment of products and services. General retailing includes junior department stores, discount stores, men's specialty apparel shops, specialty department stores and large do-it-yourself home-improvement centers. Seven modern regional distribution centers support these retail locations.



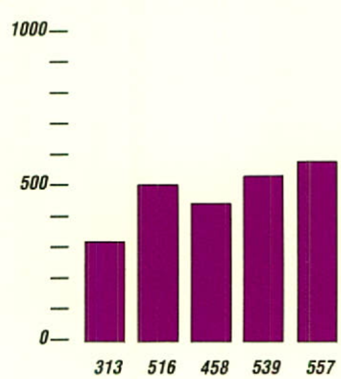


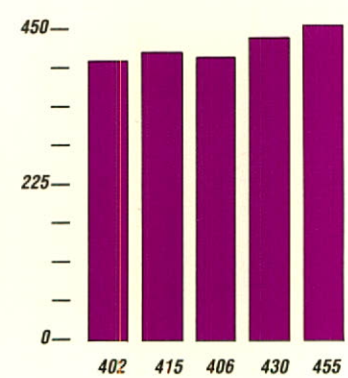
Footwear Manufacturing and Retailing Group operates 875 retail shoe stores and leased shoe departments in 43 states in this country, as well as in Australia, Canada and Mexico. The group also styles, manufactures and distributes primarily men's footwear in most major price ranges in the United States, Canada and Australia. There are 15 shoe manufacturing plants and three major distribution centers in operation.





Furniture and Home Furnishings Group manufactures and distributes quality furniture and home furnishings. There are 46 factories and 12 major distribution centers and consolidation warehouses located throughout the United States. The company also owns and operates 17 galleries and accessory stores.





Major Apparel Brands for Men:
Allyn St. George
Big Yank
Campus
Campusport
Cherokee
Clipper Mist
Cowden
Cowden Genes
Don Robbie
Donegal
Fog
Field & Stream
I-Hat
John Alexander
Le Tigré
London Fog
London Towne
Maincoats
Outdoors Unlimited
Private Line
Rough Rider
Rugged Country
Startown
Tailor's Bench
Tour de France
Winning Edge
Work-Mates by Big Yank

Major Apparel Brands for Women:
Abe Schrader
Anne Marie Beretta
Blake
Casual Acquaintance Collection
C'est Petite
Clipper Mist
College-Town
Cowden
Cowden Genes
Devon
Fog
It's Pure Gould
John Alexander
Lady Devon
Le Tigré
Le Tigré, Jr.
London Fog
London Towne
Maincoats
Mort Schrader Suit
Outdoors Unlimited
Pant-her
The Petite Concept
Queen Casuals
REJOICE!
Schrader Sport Dresses
Schrader Sport Separates
Smith & Jones
Smith & Jones For Her
Smith & Jones Petite
Stuffed Shirt
T. A. Whitney
Tour de France

Major Retail Trading Names:
Benchley
Carithers
Central Hardware
Falk's ID
Fine's
Golde's
Idaho Department Store
Jeans Galore
Keith O'Brien
Sky City Discount Center
Standard Sportswear
Thornton's
United Shirt

Major Footwear Brands for Men:
Ambassador
Apple by Ambassador
Florsheim
Florsheim Designer Collection
Florsheim Imperial
Royal Imperial by Florsheim
Christian Dior
Idlers by Florsheim
Weeds from Florsheim
Grizzlies
Hy-Test
Julius Marlow
Outdoorsman
Pro Action
Rand
Sea Tracs by London Fog
Winthrop
Worthmore

Major Footwear Brands for Women:
Avenue
Crawdads
diVina
Florsheim
J.G. Hook
Marshmallows
Miss Wonderful
Personality
Sea Tracs by London Fog
Thayer McNeil

Major Retail Trading Names:
Florsheim Shoe Shops
Florsheim Thayer McNeil
Duane's
Miller Taylor
Phillips
Thompson, Boland & Lee

Major Furniture and Home Furnishings Brands:
Ethan Allen
Broyhill
Kling
Knob Creek
Restocrat
Lenoir House
Broyhill Premier

Major Retail Trading Names:
Carriage House
Georgetown
Georgetown Manor
Manor House
Broyhill Showcase Gallery

Apparel Manufacturing

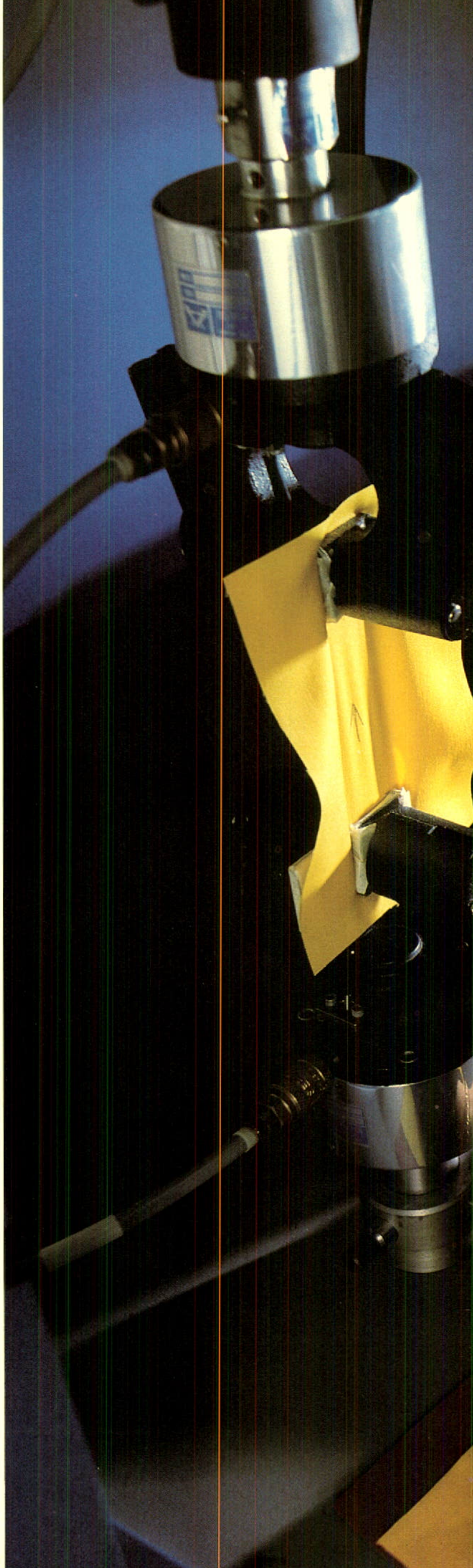
Apparel Manufacturing Group results for fiscal 1985 were negatively impacted as a result of two principal factors: the general slowdown in consumer spending which began during the summer months and the build-up of inventories at the retail level. Sales in fiscal 1985 totaled $943.1 million, a 7.2 percent increase over sales of $880.1 million in the previous year. Operating earnings (before corporate expenses, interest cost and income taxes) of $83.0 million, decreased 17.4 percent from the $100.6 million earned in the prior year. The resultant return on sales was 8.8 percent in fiscal 1985 versus 11.4 percent in fiscal 1984.

In the face of the past year's economic environment which affected the apparel industry as a whole, the INTERCO companies continued to focus on the important changes in their respective market segments while also emphasizing programs to manage assets and control costs. For example, several new divisions were added by *Queen Casuals* and *Devon* in order to serve the fashion needs of the upwardly mobile career woman. *Abe Schrader* introduced the new *Anne Marie Beretta* designer coat collection. *Biltwell* expanded its product offerings with the addition of the *Don Robbie* line of designer men's apparel.

INTERCO's apparel companies are widely recognized as innovators in manufacturing. New techniques during the past year included *Londontown's* installation of the latest state-of-the-art computer marker-making equipment. When coupled with *Londontown's* continued emphasis on productivity programs, the new equipment significantly reduced manufacturing time and enabled the company to react quickly to fashion changes with lower inventory levels. Selective offshore sourcing on the part of the apparel group during fiscal 1985 was directed toward lower production costs with corresponding improvement in value to the consumer.

The overall objective of the Apparel Manufacturing Group is to remain the leading supplier to those markets serving the middle-to-upper-income consumer and offering above-average growth and profit opportunities.

INTERCO's apparel companies enjoy strong brand recognition and consumer identification. Although the industry is subject to both changes in consumer taste and fluctuations in the overall economy, continued emphasis on market leadership and productivity improvement during the past year position INTERCO for continued growth in the years ahead.



All fabrics are tested in *Londontown's* Quality Control Laboratory against rigid company standards for strength, durability and color. The test shown determines fabric tensile strength.

General Retail Merchandising

Results for the company's General Retail Merchandising Group in fiscal 1985 were affected by the realignment of INTERCO's retailing operations. Sales of $545.3 million represented a decrease of 21.4 percent from $693.9 million a year ago. Operating earnings of $17.3 million declined 40.3 percent from last year's earnings of $29.0 million. The return on sales was 3.2 percent versus 4.2 percent for fiscal 1984. Sales volume for those retail companies not affected by the asset redeployment program was up 10.6 percent over fiscal 1984.

INTERCO's asset redeployment program focused mainly on the company's retail operations which, in recent years, have yielded the lowest returns on sales and assets of INTERCO's four operating groups. In October, 1984, the company sold *Alberts, Inc.*, a Detroit-based chain of 63 women's specialty stores, and, in early 1985, the *Eagle Family Discount Stores* operation was similarly divested. While the retail group felt the effects of the overall discounting and promotional activity resulting from inventory liquidations by retailers, the asset redeployment program positions the company for improved return on both sales and assets in the years ahead.

While the retail business involves some exposure to the economic cycle, it is the company's direction to focus on those areas of retailing offering maximum future growth and also showing resilience to overall economic trends.

Central Hardware's success is due primarily to this do-it-yourself home improvement retailer's emphasis on market leadership in key Midwest localities. As a leader, *Central Hardware* enjoys economies of scale in advertising, purchasing and other areas, thus reinforcing its dominant position and resulting in competitive pricing to the benefit of its customers. Other INTERCO retail operations serve smaller geographical regions where they are generally leaders in these markets. For example, *Sky City Discount Stores* serves smaller communities with attractive demographic characteristics in the Southeastern United States.

Although net sales for the General Retail Merchandising Group declined during fiscal 1985 as a result of the asset redeployment program, long-term profitability of the group and the ability of INTERCO's existing retail operations to achieve corporate strategic growth objectives in the years ahead have been significantly enhanced through actions taken during the past year.

Central Hardware's **computerized energy management system has provided significant annual savings despite continually rising energy rates. This system monitors and controls the heating, ventilating and air conditioning systems in Central stores.**

Footwear Manufacturing and Retailing

Sales for the Footwear Manufacturing and Retailing Group during fiscal 1985 increased 2.6 percent to $580.4 million compared with $565.9 million for the prior year. Operating earnings were $54.7 million compared with the $58.5 million in fiscal 1984, a 6.5 percent decrease. Return on sales was 9.4 percent versus 10.3 percent the prior year. These results are noteworthy compared to other domestic footwear producers and retailers during the past year.

The footwear group enjoys market leadership positions in men's footwear, as well as in important specialty markets such as safety shoes. Leading brands include *Florsheim, Florsheim Imperial, Royal Imperial* by *Florsheim, Hy-Test, Sea Tracs* by *London Fog* and a number of designer labels such as *Christian Dior* and *J.G. Hook,* the latter introduced in fiscal 1985. These leading brands and designer lines appeal to the middle-to-upper-income consumer.

Innovations in footwear manufacturing are not new to the company. During the past year, to offer a better quality product for the consumer, *Florsheim* implemented an improved sole leather cutting system and installed a new generation of computer-aided design equipment. The results are savings in material usage, reduced labor cost and accelerated new style development.

INTERCO operates one of the country's largest footwear specialty retailing operations. The *Florsheim* brand name is synonymous with market leadership in both the manufacturing and retailing of men's shoes. In maintaining this position, during fiscal 1985, 39 new *Florsheim* stores were opened and 41 were remodeled. Advertising and marketing programs were expanded to increase consumer traffic. *Senack,* which operates leased shoe departments in leading department and specialty stores, also expanded operations during fiscal 1985. *International Shoe* made significant progress in increasing market share with its women's lines through improved merchandising programs and remains the leader in the safety shoe industry with its nationally known *Hy-Test* safety shoe.

Innovation also characterized INTERCO's footwear retailing operations in fiscal 1985. An experimental electronic retailing system was installed in several locations by *Florsheim.* The system's video display allows the consumer to see and order merchandise from the full range of styles and colors offered by *Florsheim.* This exciting concept offers potential for entry into markets not presently served by *Florsheim.*

Market leadership, combined with continued innovation in manufacturing and marketing techniques, should enable the footwear group to achieve increased growth and profitability in the future.

A consumer operated electronic retailing system enables customers to select and order for home delivery from the complete *Florsheim* product line. This unique system is currently being tested in a number of markets.

Furniture and Home Furnishings

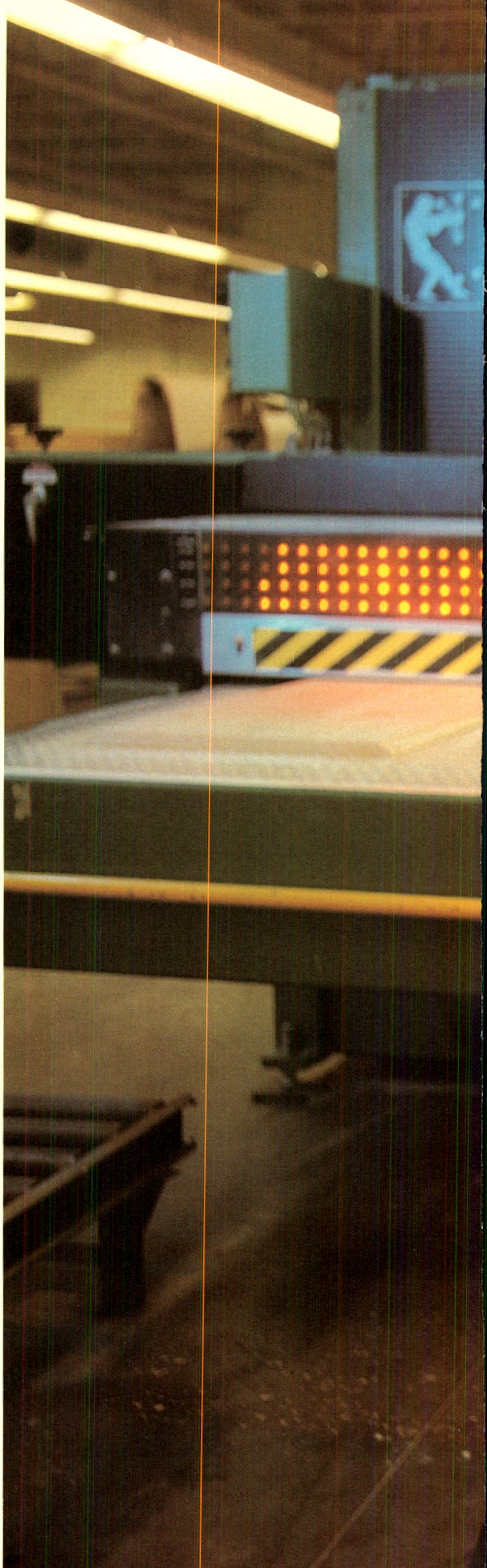
The general softening in the economy slowed the growth of INTERCO's Furniture and Home Furnishings Group sales and operating earnings in fiscal 1985. Sales advanced 3.3 percent to $556.9 million versus the prior year's $539.0 million while operating earnings totaled $53.9 million, a 9.0 percent decline from fiscal 1984 earnings of $59.2 million. Return on sales was 9.7 percent versus 11.0 percent for the prior year.

Ethan Allen and *Broyhill* are two of the finest and best known consumer brand names in the furniture industry and are responsible for INTERCO's position as the country's largest furniture producer.

Quality and customer service are integral to INTERCO's market leadership in furniture manufacturing. *Ethan Allen,* through its dealer network of approximately 300 independently-owned *Ethan Allen* Galleries, is one of the world's largest providers of furniture and home furnishings. Its strategic planning calls for the opening of a number of new Galleries in fiscal 1986. Sensitivity to changing consumer demands is typified by the 1985 introduction of additional home entertainment center furniture which accommodates various consumer electronic products. Expansion of *Ethan Allen's* innovative home delivery centers continued during the past year. This program constitutes an industry "first" in providing consumers with reliable delivery of quality furniture.

Broyhill continued to expand its successful Showcase Gallery program with over 175 dealer-operated Galleries opened by year-end, an increase of 55 locations over the past 12 months. *Broyhill's* long-term objective is to increase substantially the portion of its business obtained through this successful distribution program.
Examples of *Broyhill's* concentration on productivity improvements in its manufacturing facilities included installation of a new electrostatic finishing system and a computerized feed-through lumber cutting system during the year.

INTERCO's Furniture and Home Furnishings Group continues to emphasize ongoing marketing and productivity improvement programs designed to support long-term growth. Demographic trends should benefit the furniture and home furnishings industries over the next decade as today's 25 to 40 year-old consumer, who is a key prospect for new home formation and resultant furniture purchases, represents a significant percentage of the United States population.



Broyhill's microprocessor-controlled machines sand furniture components to preprogrammed thicknesses to ensure product consistency and quality, while maintaining cost efficiency.

Management's Discussion and Analysis of Results of Operations and Financial Condition

Results of Operations

This discussion supplements the detailed information presented in the consolidated financial statements and footnotes which begin on page 20. In addition, reference should be made to the operations review on pages 6 through 13.

Asset Redeployment Program–On November 1, 1984, the company announced that it would accelerate its asset redeployment program under which certain operating divisions not meeting the long-term profitability requirements of the company would be sold or liquidated. To cover the estimated costs and expenses associated with the program, a pretax reserve of $35 million ($20 million after tax, or $1.23 per share) was provided in the third quarter ended November 30, 1984. Accordingly, the sales and earnings of the operating divisions involved in this program are not included in the results of operations for the last six months of fiscal 1985.

Net Sales–Net sales for fiscal 1985 were $2.63 billion, a decrease of 2.0% from the $2.68 billion reported in fiscal 1984. The decrease in fiscal 1985 was attributable to the asset redeployment program in the Apparel and General Retail Groups of the company. Excluding the effect of the asset redeployment program, sales would have risen by 1.3%. Sales from continuing operations, on a comparable basis, increased by 3.2%, with the men's apparel group reporting the largest gains.

Net sales for fiscal 1984 were $2.68 billion, an increase of 4.4% from the $2.57 billion reported in fiscal 1983. Each of the company's four operating groups achieved sales gains led by the Furniture Group whose volume increased by 17.8%. Net sales for fiscal 1983 were $2.57 billion, down 4.0% from the $2.67 billion reported for fiscal 1982. In fiscal 1983, the economic downturn continued to have an impact on all segments of the company. The Furniture Group showed a decrease of 11.2% with most of the decrease coming in the case goods operation. The softness in the sales of men's shoes, both at wholesale and retail, along with the decline in the sales of safety shoes which depends on industrial employment resulted in a decrease of 7.0% in the sales of the Footwear Group.

Other Income, Net–For fiscal 1985, other income decreased by 28.4% after rising by 49.4% in fiscal 1984 as compared to fiscal 1983. The increase for fiscal 1984 was due principally to increased interest income, gains on the sale of marketable equity securities, insurance settlements and net debt retirements, which were not present, to the same extent, in fiscal 1985 or 1983.

Gross Margins–Gross margins for fiscal 1985 were $811.8 million, or 30.9% of net sales, a decrease from the $858.5 million, or 32.0% of net sales in fiscal 1984. The lower margins were attributable to a higher level of promotions and discounting by retailers industrywide, particularly in apparel and footwear products, shorter manufacturing runs which adversely affected production efficiencies and start-up costs associated with new product introductions.

Gross margins for fiscal 1984 increased from the $807.1 million, or 31.4% of net sales in fiscal 1983 due, primarily, to improved sales volume and plant utilization, and cost reduction programs.

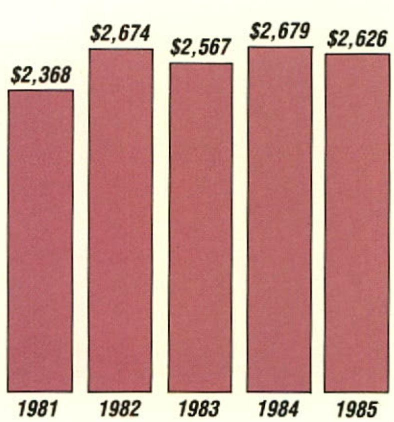
Selling, General and Administrative Expenses–Selling, general and administrative expenses were $638.2 million, $650.3 million and $635.9 million for fiscal 1985, 1984 and 1983, respectively. For fiscal 1985 and 1984, selling, general and administrative expenses, before the costs associated with the asset redeployment program in fiscal 1985, were 24.3% of net sales, a decrease from the 24.8% in fiscal 1983. The improvement in selling, general and administrative expenses as a percent of sales in fiscal 1984, and the continued performance in fiscal 1985, was due principally to cost and expense reduction programs. Fiscal 1984 also benefited from improved sales.

Interest Expense–Interest expense in fiscal 1985 amounted to $26.4 million compared to $31.7 million and $35.1 million in fiscal 1984 and 1983, respectively. The decline of 16.6% in fiscal 1985 was attributable to a reduction in the level of long-term debt. The decline of 9.7% in fiscal 1984 was attributable to a reduced level of long-term borrowing and the elimination of any short-term domestic borrowing during the year.

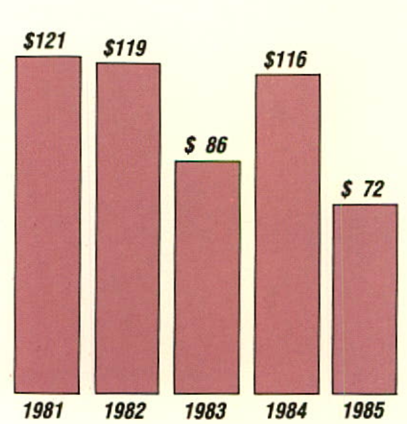
Income Taxes–The effective tax rate for fiscal 1985 was 49.9% compared to 47.4% and 48.3% in fiscal 1984 and 1983, respectively. The increase in the effective rate for fiscal 1985 was attributable to certain nondeductible expenses associated with the asset redeployment program, and a higher effective state rate, whereas the fiscal 1984 rate benefited favorably from certain capital gains.

Earnings Per Share–Earnings per share for fiscal 1985 were $4.45, a decrease of 36.6% from the $7.02 in fiscal 1984 which reflected a 34.5% increase from fiscal 1983. The earnings in fiscal 1985 were impacted by a charge of $1.23 per share to cover the estimated costs and expenses associated with the asset redeployment program. Excluding this charge, earnings per share decreased by 19.1% from fiscal 1984. The increase in earnings per share in fiscal 1984 reflected the strong showing of the Furniture Group, the effects of cost curtailment programs, and the reduced level of interest expense. The average shares outstanding for the last three years remained fairly constant.

Net Sales
In Millions



Net Earnings
In Millions



Management's Discussion and Analysis of Results of Operations and Financial Condition (cont'd)

Financial Condition

The company made a decision to accelerate the asset redeployment program whereby its assets would be more effectively utilized to improve returns and maintain a strong financial condition.

- Working capital, the excess of current assets over current liabilities, was $781.3 million at the end of fiscal 1985. The current ratio was 4.2 to 1 at February 28, 1985, the same as the prior year.

- Cash and short-term investments totaled $45.5 million at year end, a decrease of $81.1 million from the prior year. These funds were utilized in the purchase of Abe Schrader Corporation, improvements to property and equipment, and repurchase of common treasury shares.

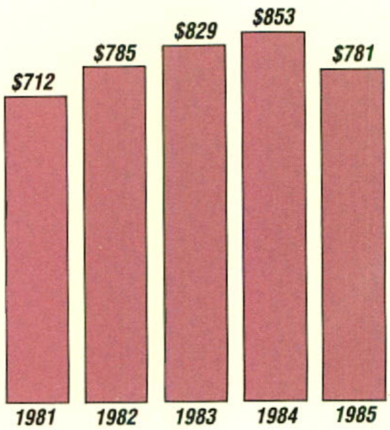
- Accounts receivable were $335.3 million at February 28, 1985, an increase of $6.2 million from the prior year. The increase for the current year was due to the receivables of the purchased company and increased levels of sales from continuing businesses, net of reductions due to operations disposed of during the year.

- Inventories were $615.3 million, a decrease of $26.0 million, or 4.0% from the prior year. The decrease was principally attributable to the disposal of businesses associated with the asset redeployment program. Inventories for continuing businesses were held level for the current fiscal year.

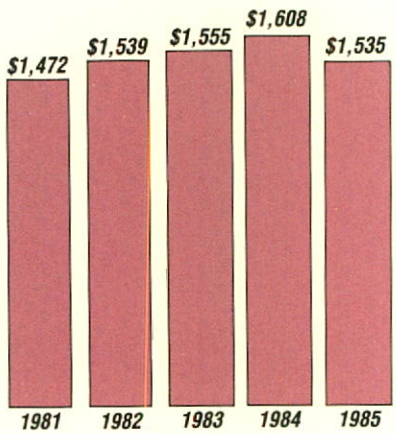
- Accounts payable and accrued expenses decreased $8.6 million, or 3.8%, reflecting the lower level of inventories.

- Long-term debt decreased by $6.6 million during the year after a decrease of $53.4 million in fiscal 1984, as a result of normal debt retirements, offset by certain new project financings. The principal decreases in fiscal 1984 were the exchange of 100,000 common shares plus $5.6 million in cash for $15.9 million face value of the 4⅝% promissory notes and the repurchase of $25.0 million of 14¼% promissory notes.

Working Capital
In Millions



Total Assets
In Millions



Financing Arrangements–At each fiscal year-end, the company had no short-term borrowings. To meet short-term working capital requirements, the company maintains a credit agreement enabling it to borrow up to $100 million in domestic or Euro-Dollar loans through February 28, 1987. Borrowings outstanding as of February 28, 1987 are repayable from that date through February 28, 1991. This credit facility is primarily intended to support commercial paper borrowings as required. The company also maintains other bank lines of credit as credit availability and additional support for the sale of commercial paper.

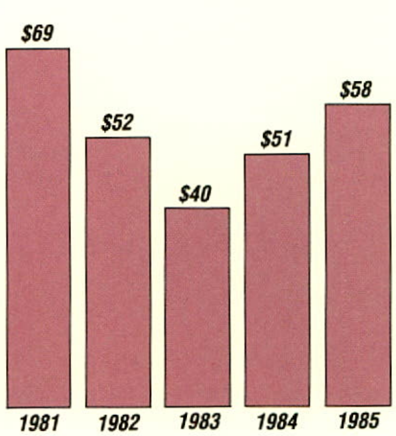
Capital Expenditures–The company maintains formalized procedures for the review of capital expenditures. These include return on investment and project payback analyses. Capital expenditures, for company-owned and capitalized leased property, aggregated $270.5 million during the last five years, of which $58.4 million occurred in fiscal 1985. Cash flow from operations provides the principal source of funds to support capital expenditures.

Inflation Accounting–In Note 16 of the Notes to Consolidated Financial Statements, the company reports on Inflation Accounting based on the Consumer Price Index for all Urban Consumers as required by the Financial Accounting Standards Board.

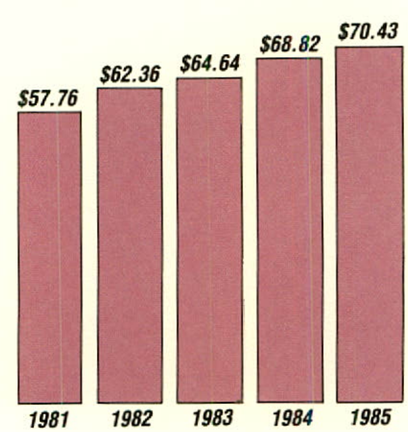
Dividends–Fiscal 1985 was the 74th consecutive year of cash dividend payments. Cash dividends of $50.3 million were paid during the fiscal year, with $44.3 million to holders of common stock and the remainder to holders of preferred stock.

The quarterly dividend rate on common stock was increased 6.9 percent to $0.77 per common share, or an annual indicated rate of $3.08 per common share, effective with the July 15, 1984 payment.

Capital Expenditures
In Millions



Book Value Per Share



Management's Discussion and Analysis of Results of Operations and Financial Condition (cont'd)

Capital Stock–The common and preferred shares of INTERCO are traded on the New York Stock Exchange. Fluctuation in the high and low quoted prices, for each quarter, are shown in the following:

	Fiscal 1985		Fiscal 1984		Fiscal 1983	
	Common		Common		Common	
	High	**Low**	High	Low	High	Low
First quarter	**$ 61**	**$ 56**	$ 75¼	$ 63¼	$ 46	$ 41
Second quarter	**62¾**	**55**	85	64¾	43¾	35½
Third quarter	**60⅞**	**55¾**	72½	64	59⅛	42½
Fourth quarter	**65¼**	**58⅜**	70	58½	64½	58

	Preferred		Preferred		Preferred	
	High	**Low**	High	Low	High	Low
First quarter	**$130⅛**	**$121⅛**	$162¾	$137½	$ 99½	$ 90
Second quarter	**135**	**120**	183	142	93½	78½
Third quarter	**129½**	**121½**	154¼	140	127½	91
Fourth quarter	**140**	**127**	151¼	128½	138¾	126

The closing market price of INTERCO's common and preferred stock at fiscal year end 1985 was $62 and $138 per share, respectively.

The repurchase of common treasury shares continued during fiscal 1985 with 960,500 shares being acquired at a cost of $58.1 million. Under the current Board authorization, the company may purchase up to 39,500 additional common shares. The company also transferred 11,050 common treasury shares into the Employee Stock Ownership Plan (ESOP).

Trademarks and Trade Names–The trademarks, trade names and licensed trademarks of INTERCO and its subsidiaries, appearing in this Annual Report, are italicized.

Form 10-K Annual Report–A copy of INTERCO INCORPORATED's current Form 10-K filed with the Securities and Exchange Commission can be obtained by writing to: Treasurer, INTERCO INCORPORATED, Post Office Box 8777, St. Louis, Missouri 63102.

INTERCO Consolidated Financial Statements

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Consolidated Balance Sheet
(Dollars in thousands)

Assets	February 28, 1985	February 29, 1984	February 28, 1983
Current assets:			
Cash	**$ 12,992**	$ 11,996	$ 14,801
Marketable securities	**32,465**	114,603	100,744
Receivables, less allowances of $16,834 ($15,318 in 1984 and $15,374 in 1983)	**335,258**	329,054	291,130
Inventories	**615,267**	641,235	642,314
Prepaid expenses and other current assets	**30,789**	22,654	18,061
Total current assets	**1,026,771**	1,119,542	1,067,050
Marketable securities	**7,535**	10,297	11,199
Property, plant and equipment:			
Land	**25,071**	25,075	25,710
Buildings and improvements	**375,168**	376,829	368,121
Machinery and equipment	**256,761**	257,039	254,543
	657,000	658,943	648,374
Less accumulated depreciation	**255,908**	250,578	238,401
Net property, plant and equipment	**401,092**	408,365	409,973
Other assets	**99,843**	69,628	66,753
	$1,535,241	$1,607,832	$1,554,975

See accompanying notes to consolidated financial statements.

Liabilities and Shareholders' Equity	**February 28, 1985**	February 29, 1984	February 28, 1983
Current liabilities:			
Current maturities of long-term debt	**$ 15,066**	$ 13,622	$ 14,529
Current maturities of capital lease obligations	**5,823**	6,047	5,953
Accounts payable	**148,298**	156,227	130,923
Accrued employee compensation	**38,582**	39,249	36,983
Other accrued expenses	**33,959**	34,001	31,810
Income taxes	**3,710**	17,549	18,010
Total current liabilities	**245,438**	266,695	238,208
Long-term debt, less current maturities	**133,311**	139,914	193,341
Obligations under capital leases, less current maturities	**61,403**	69,002	73,785
Other long-term liabilities	**30,325**	31,258	26,410
Shareholders' equity:			
Preferred stock, no par value, authorized 10,000,000 shares—issued 733,037 shares in 1985, 802,085 shares in 1984 and 908,136 shares in 1983	**73,304**	80,209	90,814
Common stock, $7.50 stated value, authorized 50,000,000 shares—issued 15,613,525 shares in 1985, 15,420,324 shares in 1984 and 15,113,074 shares in 1983	**117,102**	115,652	113,348
Capital surplus	**91,496**	84,242	66,885
Retained earnings	**863,019**	843,635	778,866
	1,144,921	1,123,738	1,049,913
Less 1,536,915 (587,465 and 687,465 in 1984 and 1983, respectively) shares of common stock in treasury, at cost	**80,157**	22,775	26,682
Total shareholders' equity	**1,064,764**	1,100,963	1,023,231
	$1,535,241	$1,607,832	$1,554,975

Consolidated Statement of Earnings

(Dollars in thousands except per share data)

Years Ended	February 28, 1985	February 29, 1984	February 28, 1983
Income:			
Net sales	**$2,625,746**	$2,678,886	$2,566,606
Other income, net	**31,852**	44,495	29,779
	2,657,598	2,723,381	2,596,385
Costs and expenses:			
Cost of sales	**1,813,934**	1,820,366	1,759,527
Selling, general and administrative expenses	**638,151**	650,332	635,910
Interest expense	**26,400**	31,662	35,072
Asset redeployment expenses	**35,010**	—	—
	2,513,495	2,502,360	2,430,509
Earnings before income taxes	**144,103**	221,021	165,876
Income taxes	**71,940**	104,827	80,114
Net earnings	**$ 72,163**	$ 116,194	$ 85,762
Earnings per share	**$4.45**	$7.02	$5.22

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

(Dollars in thousands)

Years Ended	February 28, 1985	February 29, 1984	February 28, 1983
Working capital provided by:			
Net earnings	**$ 72,163**	$116,194	$ 85,762
Items not affecting working capital:			
Depreciation	**44,643**	42,524	41,469
Other, net	**5,886**	10,509	9,665
Operations	**122,692**	169,227	136,896
Disposal of property, plant and equipment	**24,177**	10,400	4,991
Issuance of preferred stock	**17**	29	231
Issuance of common stock	**9,381**	20,665	14,943
Additions to long-term debt	**12,919**	5,100	10,750
Additions to capital lease obligations	**2,337**	3,431	3,965
Reduction of marketable securities	**2,972**	1,047	3,613
	174,495	209,899	175,389
Working capital used for:			
Cash dividends	**50,330**	48,631	48,496
Additions to property, plant and equipment:			
Company owned property	**56,023**	47,627	36,144
Capitalized leased property	**2,337**	3,431	3,966
Reduction of long-term debt	**19,137**	58,687	14,906
Reduction of capital lease obligations	**11,724**	8,214	7,000
Purchase of common treasury shares	**58,057**	—	4,525
Conversion of preferred stock	**6,924**	10,638	9,000
Other, net	**22,358**	8,666	7,838
	226,890	185,894	131,875
Acquisition (less working capital of $19,126):			
Properties	**4,062**	—	—
Capital lease obligations	**(1,788)**	—	—
Excess of cost over fair value of net assets acquired	**16,695**	—	—
Other, net non-current assets	**150**	—	—
Net non-current assets	**19,119**	—	—
	246,009	185,894	131,875
Increase (decrease) in working capital	**$ (71,514)**	$ 24,005	$ 43,514
Working capital increased (decreased) by:			
Cash and marketable securities	**$ (81,142)**	$ 11,054	$ 88,535
Receivables	**6,204**	37,924	(11,747)
Inventories	**(25,968)**	(1,079)	(51,870)
Prepaid expenses and other current assets	**8,135**	4,593	(1,476)
Current maturities of long-term debt	**(1,444)**	907	(476)
Current maturities of capital lease obligations	**224**	(94)	(1)
Accounts payable and accrued expenses	**8,638**	(29,761)	21,348
Income taxes	**13,839**	461	(799)
	$ (71,514)	$ 24,005	$ 43,514

See accompanying notes to consolidated financial statements.

Consolidated Statement of Shareholders' Equity

(Dollars in thousands except per share data)

	Preferred Stock	Common Stock Issued	Common Stock Treasury	Capital Surplus	Retained Earnings	Total
Balance February 28, 1982	$ 99,572	$110,789	$(22,157)	$54,512	$742,356	$ 985,072
Net earnings					85,762	85,762
Cash dividends:						
Preferred stock					(7,478)	(7,478)
Common stock–$2.88 per share					(41,018)	(41,018)
Conversion of debentures:						
Series D–2,419 shares	242			(11)		231
Conversion of preferred stock:						
Series D–90,005 shares	(9,000)	1,460		7,540		—
Exercise of stock options:						
Common–146,549 shares		1,099		4,844		5,943
Purchase of 115,800 common treasury shares			(4,525)			(4,525)
Investment valuation allowance					247	247
Foreign currency translations					(1,003)	(1,003)
Balance February 28, 1983	90,814	113,348	(26,682)	66,885	778,866	1,023,231
Net earnings					116,194	116,194
Cash dividends:						
Preferred stock					(6,701)	(6,701)
Common stock–$2.88 per share					(41,930)	(41,930)
Conversion of debentures:						
Series D–329 shares	33			(4)		29
Conversion of preferred stock:						
Series D–106,380 shares	(10,638)	1,725		8,911		(2)
Exercise of stock options:						
Common–77,142 shares		578		3,174		3,752
Restricted stock plan:						
Common–133 shares		1		7		8
Issuance of 100,000 common treasury shares in exchange for notes			3,907	5,269	(2,907)	6,269
Foreign currency translations					113	113
Balance February 29, 1984	80,209	115,652	(22,775)	84,242	843,635	1,100,963
Net earnings					72,163	72,163
Cash dividends:						
Preferred stock					(5,985)	(5,985)
Common stock–$3.03 per share					(44,345)	(44,345)
Conversion of debentures:						
Series D–189 shares	19			(2)		17
Conversion of preferred stock:						
Series D–69,237 shares	(6,924)	1,123		5,800		(1)
Exercise of stock options:						
Common–43,518 shares		327		1,469		1,796
Purchase of 960,500 common treasury shares			(58,057)			(58,057)
Issuance of 11,050 common treasury shares to ESOP			675	(13)		662
Foreign currency translations					(2,449)	(2,449)
Balance February 28, 1985	$ 73,304	$117,102	$(80,157)	$91,496	$863,019	$1,064,764

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(Dollars in thousands except per share data)

1. Significant Accounting Policies

The company and its subsidiaries follow generally accepted accounting principles to present fairly their consolidated financial position, results of operations, and changes in financial position. The major accounting policies of the company are set forth below.

Principles of Consolidation–The consolidated financial statements include the accounts of the company and all its subsidiaries, the majority of which are wholly owned. All material intercompany transactions have been eliminated in consolidation.

Fiscal Year–The company's fiscal year ends on the last day of February. In this report, reference to fiscal 1985 refers to the fiscal year ended February 28, 1985, fiscal 1984 refers to the fiscal year ended February 29, 1984, and fiscal 1983 refers to the fiscal year ended February 28, 1983.

Marketable Securities–Marketable equity securities (common and preferred stocks) are stated at the lower of cost or market. Aggregate net unrealized losses are included in results of operations if related to current assets and in shareholders' equity if related to non-current assets. Other marketable securities are stated at cost unless there is an indication of permanent impairment of value, in which case the adjustment to market value is included in results of operations. The cost of marketable securities sold is determined on the specific identification method.

Inventories–Inventories are stated at the lower of cost (first-in, first-out) or market, except for most footwear manufacturing and certain general retail inventories which are valued on the "last-in, first-out" method of inventory valuation.

Property, Plant and Equipment–Property, plant and equipment, including facilities and equipment leased under capital leases, are stated at cost. Expenditures for improvements are capitalized, while normal repairs and maintenance are expensed as incurred. When properties are retired or otherwise disposed of, the related cost and accumulated depreciation or amortization are removed from the accounts and gains or losses on the dispositions are reflected in results of operations.

For financial reporting purposes, the company utilizes both accelerated and straight-line methods of computing depreciation and amortization. Such expense is computed based on the estimated useful lives of the respective assets or term of lease, if less, which generally range from 15 to 40 years for buildings and improvements, and from 3 to 20 years for machinery and equipment. Approximately 80% of depreciation and amortization expense was computed using the straight-line method in each fiscal year presented.

Excess of Cost Over Fair Value of Net Assets Acquired–The excess of cost over fair value of net assets of companies acquired is included in other assets and is being amortized on a straight-line basis, generally over 40 years.

Start-Up Expenses–Start-up expenses of new facilities are charged to results of operations in the fiscal year incurred.

Pension Plans–For financial reporting purposes, the company's policy is to provide for current costs and amortization of prior service costs over 30 years. Amounts funded meet or exceed the funding requirements of the Employee Retirement Income Security Act of 1974.

Income Taxes–Deferred income taxes are provided on certain transactions which are reported for financial reporting purposes in different periods than for income tax purposes. Investment tax credits are reflected as a reduction of Federal income taxes in the period in which qualified property is placed in service. It is the company's intent that the undistributed earnings of its subsidiaries will either be reinvested in the subsidiaries or distributed tax-free to the parent company. Generally, no provision has been made for income taxes on such undistributed earnings.

Notes to Consolidated Financial Statements (cont'd)
(Dollars in thousands except per share data)

2. Business Combination

On March 15, 1984, the company acquired all the outstanding stock of Abe Schrader Corporation for $38,245 in cash. This transaction was accounted for as a purchase, and accordingly, the results of operations of Abe Schrader Corporation have been included in the company's consolidated statement of earnings from the date of the acquisition. The results of operations of the purchased company are not material to the consolidated statement of earnings.

3. Inventories

Inventories are summarized as follows:

	1985	1984	1983
Retail merchandise	**$230,329**	$256,746	$288,165
Finished products	**201,478**	191,715	178,487
Work in process	**55,724**	57,610	55,625
Raw materials	**127,736**	135,164	120,037
	$615,267	$641,235	$642,314

All of the major categories of inventory include certain items valued on the "last-in, first-out" method. Had the "first-in, first-out" method been applied to all inventories, they would have been stated at $648,656, $674,193 and $674,484 at fiscal years ended 1985, 1984 and 1983, respectively.

4. Marketable Securities

Marketable securities classified as current are stated at cost which approximates market.

Marketable securities classified as non-current are summarized below:

	1985	1984	1983
Equity securities–market value	**$6,743**	$ 3,852	$ 5,091
Equity securities–cost	**$1,488**	$ 1,926	$ 2,973
Other marketable securities–cost	**6,047**	8,371	8,226
	$7,535	$10,297	$11,199

Realized gains (losses) on the sale of securities included in the determination of earnings amounted to $(90), $3,207 and $88 for fiscal 1985, 1984 and 1983, respectively.

5. Lines of Credit

The company has a revolving credit agreement with a number of U.S. banks which enables it to borrow up to $100,000 in domestic or Euro-Dollar loans through February 28, 1987. Borrowings outstanding as of February 28, 1987 are repayable from that date through February 28, 1991. Domestic interest rates will approximate bank prime while rates for Euro-Dollar borrowings will approximate the London Inter-Bank Offering Rate plus 0.375%. The agreement requires the company to pay a commitment fee of 0.25% per annum. There were no borrowings outstanding under the agreement at fiscal years ended 1985, 1984 and 1983.

The company also maintains other bank lines of credit which provide added credit availability and support for the sale of commercial paper. On February 28, 1985, the total unused lines of credit under these agreements were $74,000.

Average short-term borrowings outstanding during fiscal 1985 and 1983 were $20,000 and $25,000, respectively, with a weighted average interest rate thereon of 10.4% and 11.6%, respectively. Maximum short-term borrowings at any month-end were $33,000 and $52,300 in fiscal 1985 and 1983, respectively. There were no short-term borrowings during fiscal 1984.

6. Long-Term Debt

Long-term debt consisted of the following:

	1985	1984	1983
14¼% promissory notes due February 15, 1991	**$ 75,000**	$ 75,000	$100,000
10% promissory installment notes, payable $8,716 annually through 1985	**8,716**	17,432	26,148
4⅝% promissory installment notes, payable $1,875 annually through 1987, and balance in 1988	**5,963**	7,838	25,625
8⅝% promissory installment note, payable $1,000 annually through 1993, and balance in 1994	**14,000**	15,000	16,000
8% to 12% industrial revenue bonds maturing in varying amounts through 2011	**37,651**	29,726	28,976
4⅞% convertible subordinated debentures due January 1, 1998	**239**	259	294
Other debt at 5% to 12% interest rates, payable in varying amounts through 2006	**8,756**	10,497	13,334
	150,325	155,752	210,377
Less current maturities	**15,066**	13,622	14,529
Less market adjustment	**1,948**	2,216	2,507
	$133,311	$139,914	$193,341

Maturities of long-term debt are $15,066, $5,155, $6,334, $2,015 and $7,470 for fiscal years 1986 through 1990, respectively.

The market adjustment relates to purchase adjustments of the long-term debt assumed in the acquisition of Ethan Allen, Inc.

The 4⅞% convertible subordinated debentures are convertible into the company's Series D preferred stock prior to maturity at $105.50 per share, subject to anti-dilution provisions. They are subordinated as to principal and interest to certain indebtedness, are redeemable at the company's option prior to maturity at prices ranging from 101.875% to 100% of the principal amount, and are subject to annual sinking fund payments.

In fiscal 1984, the company exchanged 100,000 shares of its common stock plus $5,586 in cash for 66.7% of its 4⅝% promissory notes outstanding with a face value of $15,912. Also, the company repurchased $25,000 of its 14¼% promissory notes at a premium of 8.714%. The combined effect of these transactions did not have a material effect on consolidated net earnings.

The company is in compliance with the covenants of its debt agreements and does not believe that the covenants will restrict its future operations.

7. Obligations Under Capital Leases

The amount capitalized under capital leases is the lesser of the present value of the minimum lease payments or the fair value of the leased properties at the beginning of the respective lease terms. Generally, interest rates applicable to capital leases range between 4¾% and 16¾% for leased facilities and between 12% and 18½% for leased equipment. Obligations under capital leases amounted to $67,226, $75,049 and $79,738 at fiscal years ended 1985, 1984 and 1983, respectively. Maturities of these obligations are $5,823, $5,835, $5,397, $5,333 and $6,139 for fiscal years 1986 through 1990, respectively.

(Dollars in thousands except per share data)

8. Preferred Stock

The company's preferred stock is issuable in series. At fiscal years ended 1985, 1984 and 1983, the outstanding preferred stock consisted of 733,037, 802,085 and 908,136 shares, respectively, of Series D $7.75 cumulative convertible with stated and involuntary liquidating value of $100.00 per share.

Each share of the Series D preferred stock is convertible into 2.1621 shares of the company's common stock. The Series D preferred stock may be redeemed at the company's option on or after January 29, 1989, at $104.75 per share, decreasing to $100.00 per share in 1994. Subject to the satisfaction of certain conditions relating to common stock dividends paid, the Series D preferred stock may be redeemed at the company's option on or after January 29, 1986 at $107.75 per share, decreasing to $100.00 per share in 1994.

At February 28, 1985, 2,265 shares of Series D preferred stock were reserved for the conversion of the 4⅞% convertible subordinated debentures.

9. Common Stock

Shares of common stock were reserved for the following purposes at February 28, 1985:

	Number of Shares
Common stock options:	
Granted	519,890
Available for grant	27,279
Conversion of preferred stock	1,589,796
	2,136,965

Under the company's stock option plans, certain key employees may be granted incentive options, nonqualified options, stock appreciation rights, or combinations thereof. Nonqualified options and stock appreciation rights granted under the 1977 Plan may not be less than 85% of the fair market value (100% as to incentive options and related stock appreciation rights) of the common stock on the date of grant. Options and stock appreciation rights granted under the 1980 Plan may not be less than 100% of the fair market value of the common stock on the date of grant. All options which have been granted, incentive or nonqualified, were at 100% of fair market value on the date of grant. Incentive options and nonqualified options expire ten years after the date of grant. At February 28, 1985, no stock appreciation rights have been granted. No additional options may be granted under the 1972 Plan.

At February 28, 1985, information regarding options granted but not exercised under the three plans was as follows:

	Option Shares Outstanding	Dates of Grant	Price Range
1972 Plan	4,592	November 17, 1978 —October 15, 1981	$35.00 -$48.00
1977 Plan	61,067	November 17, 1978 —October 12, 1984	$35.00 -$73.50
1980 Plan	454,231	December 19, 1980 —October 12, 1984	$40.375-$63.50

Changes in options granted are summarized as follows:

	1985		1984		1983	
	Shares	**Average Price**	Shares	Average Price	Shares	Average Price
Beginning of year	**331,924**	**$47.92**	418,069	$46.08	522,393	$42.19
Granted	**265,950**	**56.24**	10,400	64.58	61,300	51.74
Exercised	**(43,518)**	**40.17**	(77,142)	40.37	(146,549)	34.92
Cancelled	**(34,466)**	**51.76**	(19,403)	47.20	(19,075)	43.55
End of year	**519,890**	**52.57**	331,924	47.92	418,069	46.08
Exercisable at end of year	**135,847**		101,117		102,317	

10. Income Taxes

Income tax expense is comprised of the following:

	1985	1984	1983
Current:			
Federal	**$68,583**	$ 91,304	$63,955
State and local	**10,438**	11,274	9,505
Foreign	**1,527**	1,205	2,546
	80,548	103,783	76,006
Deferred	**(8,608)**	1,044	4,108
	$71,940	$104,827	$80,114
ESOP, investment and jobs tax credits	**$ 3,074**	$ 2,632	$ 2,450

The following table reconciles the differences between the Federal corporate statutory rate and the company's effective income tax rate:

	1985	1984	1983
Federal corporate statutory rate	**46.0%**	46.0%	46.0%
State and local income taxes, net of Federal tax benefit	**4.3**	2.9	3.0
ESOP, investment and jobs tax credits	**(2.1)**	(1.2)	(1.5)
Foreign taxes, including foreign currency translation effects	**(0.2)**	(0.2)	0.6
Other	**1.9**	(0.1)	0.2
Effective income tax rate	**49.9%**	47.4%	48.3%

Certain items are recognized for income tax purposes in years other than those in which they are reported in the consolidated financial statements. Future income tax benefits and deferred credits at the end of each fiscal year are included in the accompanying consolidated balance sheet, as follows:

	1985	1984	1983
Prepaid expenses and other current assets	**$16,823**	$10,236	$ 6,694
Other long-term liabilities	**(13,324)**	(15,345)	(10,759)
	$ 3,499	$ (5,109)	$ (4,065)

The Federal income tax returns of the company and its major subsidiaries for the taxable years of 1981 and 1982 are currently in the process of examination. Management is of the opinion that the results of these examinations will have no material effect on the company's consolidated financial position or results of operations.

Notes to Consolidated Financial Statements (cont'd)

(Dollars in thousands except per share data)

11. Employee Benefits

The company and its subsidiaries have several pension plans covering substantially all employees, including certain employees in foreign countries. Total pension expense was $17,600, $19,400 and $19,400 in fiscal 1985, 1984 and 1983, respectively. Accumulated plan benefits and plan net assets for the company's defined benefit plans as of the most recent valuation dates are presented below:

	1985	1984	1983
Actuarial present value of accumulated plan benefits:			
Vested	**$143,846**	$133,232	$128,908
Nonvested	**10,182**	10,609	9,970
	$154,028	$143,841	$138,878
Net assets (at market value) available for benefits	**$146,358**	$135,536	$112,307

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 7.7%, 7.6% and 7.6% in fiscal 1985, 1984 and 1983, respectively.

During fiscal 1985, the company initiated a new Savings Plan for Employees of INTERCO INCORPORATED and Affiliates and an INTERCO INCORPORATED Employee Stock Ownership Plan (ESOP). The total cost of these Plans for fiscal 1985 was $589, net of taxes of $1,206.

The company provides certain health care and life insurance benefits for certain employees who reach retirement age. Retiree health and life insurance benefits are provided through insurance companies. Post-retirement health care and life insurance expense for fiscal 1985 was $1,470.

12. Lease Commitments

Substantially all of the company's retail outlets and certain other real properties and equipment are operated under lease agreements expiring at various dates through the year 2022. Leases covering retail outlets and equipment generally require, in addition to stated minimums, contingent rentals based on retail sales and equipment usage. Generally, the leases provide for renewal for various periods at stipulated rates.

Assets recorded under capital leases were as follows:

	1985	1984	1983
Land	**$ 783**	$ 783	$ 902
Buildings	**82,476**	90,072	90,782
Machinery and equipment	**10,660**	11,483	11,949
	93,919	102,338	103,633
Accumulated depreciation	**39,948**	40,127	37,119
	$53,971	$ 62,211	$ 66,514

Future minimum lease payments under capital leases, reduced by minimum rentals from subleases of $3,590 at February 28, 1985, aggregate $120,345 of which $67,226 is included in obligations under capital leases and current maturities, $42,094 represents interest, and the balance represents other costs of the leases including taxes, insurance and maintenance. Annual payments under capital leases are $12,800, $12,181, $11,145, $10,578 and $10,999 for fiscal years 1986 through 1990, respectively.

Total rent expense was as follows:

	1985	1984	1983
Basic rentals under operating leases	**$40,181**	$42,925	$42,379
Contingent rentals, operating and capital leases	**32,571**	31,186	30,105
	72,752	74,111	72,484
Less sublease rentals	**2,181**	1,979	2,154
	$70,571	$72,132	$70,330

Included in rent expense above is the cost of services provided by lessors of leased retail departments, estimated to aggregate $15,500, $14,200 and $12,800 in fiscal years 1985, 1984 and 1983, respectively.

Future minimum lease payments under operating leases, reduced by minimum rentals from subleases of $2,143, at February 28, 1985, aggregate $173,471. Annual payments under operating leases are $27,849, $25,292, $22,806, $19,528 and $16,795 for fiscal years 1986 through 1990, respectively.

13. Litigation

The company is or may become a defendant in a number of pending or threatened legal proceedings in the ordinary course of business. In the opinion of management, the ultimate liability, if any, of the company from all such proceedings will not have a material effect upon the consolidated financial position.

14. Earnings Per Share

Earnings per share are based on the weighted average number of shares of common stock and common stock equivalents outstanding during the year, plus those common shares which would have been issued if conversion of all preferred stock and convertible debentures had taken place at the beginning of each year or since date of issuance. Stock options, the exercise of which would result in dilution of earnings per share, are considered common stock equivalents. Net earnings for these computations are increased by the net interest expense on the convertible debentures. Primary earnings per share do not differ significantly from fully diluted earnings per share.

Notes to Consolidated Financial Statements (cont'd)
(Dollars in thousands except per share data)

15. Business Segment Information

The company's four business segments are Apparel Manufacturing, General Retail Merchandising, Footwear Manufacturing and Retailing, and Furniture and Home Furnishings. Specific information, on an unaudited basis, relating to the operating companies and their products, which comprise each segment, is included on pages 4 through 13. Summarized financial information by business segment is as follows:

	1985	1984	1983
Net sales to unaffiliated customers:			
Apparel	**$ 943,077**	$ 880,122	$ 877,341
General Retail	**545,322**	693,914	685,664
Footwear	**580,467**	565,891	546,041
Furniture	**556,880**	538,959	457,560
Total	**$2,625,746**	$2,678,886	$2,566,606
Operating earnings:			
Apparel	**$ 83,062**	$ 100,538	$ 94,843
General Retail	**17,277**	28,951	22,346
Footwear	**54,727**	58,531	57,114
Furniture	**53,882**	59,231	28,653
	208,948	247,251	202,956
Asset redeployment expenses	**(35,010)**	—	—
Corporate expenses and interest cost	**(29,835)**	(26,230)	(37,080)
Earnings before income taxes	**$ 144,103**	$ 221,021	$ 165,876
Identifiable assets at year end:			
Apparel	**$ 463,277**	$ 439,837	$ 418,563
General Retail	**235,697**	312,034	343,041
Footwear	**290,099**	280,764	280,185
Furniture	**454,580**	430,202	406,527
	1,443,653	1,462,837	1,448,316
Corporate assets	**91,588**	144,995	106,659
Total	**$1,535,241**	$1,607,832	$1,554,975
Depreciation expense:			
Apparel	**$ 11,316**	$ 9,931	$ 9,203
General Retail	**9,671**	11,400	11,565
Footwear	**7,976**	7,880	7,584
Furniture	**13,065**	12,388	12,307
Capital expenditures:			
Apparel	**$ 10,815**	$ 12,855	$ 9,870
General Retail	**14,338**	10,114	9,308
Footwear	**10,519**	7,626	7,831
Furniture	**19,646**	15,872	12,116

On November 1, 1984, the company announced that it would accelerate its asset redeployment program under which certain operating divisions not meeting the long-term profitability requirements of the company would be sold or liquidated. To cover the estimated costs and expenses associated with the program, a pretax reserve of $35,010 ($20,000 after tax, or $1.23 per share) was provided in the third quarter ended November 30, 1984. Accordingly, the sales and earnings of the operating units involved in this program are not included in the results shown above for the last six months of fiscal 1985. Without this program, net sales of the Apparel segment and the General Retail segment for fiscal 1985 would have been $949,388 and $626,477, respectively.

Substantially all of the estimated expenses of the asset redeployment program are allocated to the General Retail segment.

Sales between business segments, which account for less than 1% of the sales of any one business segment, are considered immaterial and are netted against the sales of the respective segment. Operating earnings of the business segment include its sales less all operating expenses. Minority interests in certain subsidiaries are immaterial and have been included in corporate expenses and interest cost.

Identifiable assets are those assets used by each segment in its operations. Corporate assets consist primarily of cash and marketable securities. The remaining assets of the operating units involved in the asset redeployment program are included in corporate assets under identifiable assets for fiscal 1985.

Substantially all of the company's sales are made to unaffiliated customers. No customer accounted for 10% or more of consolidated sales. Foreign operations are not material.

16. Inflation Accounting (Unaudited)

The accompanying inflation–adjusted financial information is presented in accordance with the requirements of the Financial Accounting Standards Board (FASB). The FASB requires that certain historical financial information be adjusted for the effects of specific price changes (current cost). Other information, such as historical dollar sales, dividends and common stock prices, is required to be adjusted for general inflation by applying the Consumer Price Index for All Urban Consumers (CPI-U). As acknowledged by the FASB, the methods used to prepare this data are experimental and, because of necessity, are based on assumptions, estimates and subjective judgments.

The "current cost" method measures the effect of specific price changes on inventory, and property, plant and equipment as a result of inflation. The current cost of inventories owned is the current cost of purchasing the goods concerned or the current cost of the resources required to produce the goods concerned. The current cost of inventories was determined utilizing the first-in, first-out method of inventory valuation adjusted for unrecognized price increases through application of the Bureau of Labor Statistics Producer Price Index (BLS-PPI) for those inventory items applicable to the company.

The current cost of property, plant and equipment was determined using the appropriate BLS-PPI, other externally available indices, and management's estimates and appraisals. The current cost of property measures costs of assets having the same productive efficiency as those owned by the company. Current cost does not consider the efficiencies or cost savings that might be realized by replacing existing assets with new, more efficient or more technologically advanced assets.

The purpose of current cost restatement is to provide an estimate of the impact of price changes on net earnings and cash flow. However, current cost data does not reflect specific plans for replacement of property, nor does it purport to represent precise measurement of assets and expenses. The adjustment to cost of sales reflects the change in beginning and ending inventory levels as adjusted for increases in specific prices of inventory. The adjustment to depreciation reflects the increased expense associated with the current cost valuation of property, plant and equipment. Depreciation was computed using the company's normal depreciation methods and depreciable life assumptions.

In accordance with FASB requirements, inflation adjusted net earnings do not reflect an adjustment to historical income tax expense, because present tax laws do not allow deductions for increased depreciation and cost of sales due to inflation. As a result, the adjustments made for inflation are not tax effected. Thus, the effective tax rates and net earnings on an inflation adjusted basis are distorted.

(Dollars in thousands except per share data)

The summary consolidated statement of earnings adjusted for inflation for the year ended February 28, 1985, is as follows:

	As Reported in the Consolidated Statement of Earnings	Adjusted for Specific Price Changes (Current Cost)
Net sales and other income	$2,657,598	$2,657,598
Cost of sales (excluding depreciation)	1,795,826	1,796,020
Selling, general and administrative expenses (excluding depreciation)	611,616	611,616
Depreciation expense	44,643	72,926
Interest expense	26,400	26,400
Asset redeployment expenses	35,010	35,010
Income taxes	71,940	71,940
	2,585,435	2,613,912
Net earnings	$ 72,163	$ 43,686
Earnings per share	$4.45	$2.69
Effective income tax rate	49.9%	62.2%
Purchasing power gain on net monetary assets held		$201
Increase in general inflation of inventories and net property, plant and equipment during the year		$58,426
Effect of increase in specific prices (current cost)		58,727
Excess of general inflation over specific price increases		$ (301)

The current costs of inventories and net property, plant and equipment were $647,753 and $651,437, respectively.

The following five-year comparison shows selected historical financial data adjusted for the effects of changing prices:

	1985	1984	1983	1982	1981
Current cost data:					
Net earnings	$ 43,686	$ 92,632	$ 60,976	$ 82,824	$ 62,251
Earnings per common share	2.69	5.59	3.71	5.05	3.81
Net assets at year end	1,347,595	1,386,916	1,384,509	1,324,563	1,205,824
Increase in general inflation over increase in specific prices of inventories and net property, plant and equipment	(301)	74,563	42,987	2,933	20,507
Other information adjusted for general inflation:					
Net sales and other income	2,657,598	2,835,857	2,793,710	3,064,985	2,981,906
Purchasing power gain on net monetary assets held	201	1,949	5,391	14,063	11,063
Dividends paid per common share	3.03	3.00	3.10	3.27	3.29
Market price of common stock at year end	$ 62.00	$ 61.57	$ 67.79	$ 46.21	$ 61.46
Average consumer price index	312.9	300.5	290.8	275.9	251.4

17. Quarterly Financial Information (Unaudited)

The following quarterly information includes all adjustments necessary for a fair presentation.

	First	Second	Third	Fourth
Net Sales:				
1985	**$645,528**	**$700,526**	**$698,765**	**$580,927**
1984	617,495	694,886	742,533	623,972
1983	609,268	665,533	688,454	603,351
Gross Profit:				
1985	**$199,913**	**$214,807**	**$215,146**	**$181,946**
1984	188,645	215,095	237,258	217,522
1983	190,620	200,691	214,871	200,897
Net Earnings:				
1985	**$19,468**	**$24,396**	**$ 8,339**	**$19,960**
1984	17,253	27,625	35,550	35,766
1983	16,174	19,892	25,147	24,549
Earnings Per Share:				
1985	**$1.17**	**$1.48**	**$0.54**	**$1.26**
1984	1.04	1.67	2.15	2.16
1983	0.98	1.22	1.54	1.48
Common Dividends Paid Per Share:				
1985	**$0.72**	**$0.77**	**$0.77**	**$0.77**
1984	0.72	0.72	0.72	0.72
1983	0.72	0.72	0.72	0.72

The third and fourth quarters of fiscal 1985 reflect the effects of the asset redeployment program. The sales of the operating divisions included in the program have been excluded from consolidated sales. Otherwise, sales for the third and fourth quarters would have been $743,241 and $623,917, respectively. As a result of the program, the operating results of the affected divisions have been excluded from the third and fourth quarters of fiscal 1985 and net earnings and earnings per share for the third quarter of fiscal 1985 were impacted by $20,000 and $1.23, respectively.

Independent Accountants' Report

The Board of Directors and Shareholders
INTERCO INCORPORATED:

We have examined the consolidated balance sheets of INTERCO INCORPORATED and subsidiaries as of February 28, 1985, February 29, 1984 and February 28, 1983 and the related consolidated statements of earnings, shareholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of INTERCO INCORPORATED and subsidiaries at February 28, 1985, February 29, 1984 and February 28, 1983 and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

St. Louis, Missouri
April 8, 1985

Peat, Marwick, Mitchell & Co.

Five Year Consolidated Financial Review

(Dollars in thousands except per share data)

Years Ended	**1985**	1984	1983	1982	1981
For The Year					
Summary of operations:					
Net sales	**$2,625,746**	$2,678,886	$2,566,606	$2,673,769	$2,368,456
Cost of sales	**1,813,934**	1,820,366	1,759,527	1,820,369	1,591,635
Interest expense	**26,400**	31,662	35,072	37,201	20,284
Earnings before income taxes	**144,103**	221,021	165,876	223,270	232,021
As a percent of sales	**5.5%**	8.3%	6.5%	8.4%	9.8%
Income taxes	**71,940**	104,827	80,114	104,655	110,818
Net earnings	**72,163**	116,194	85,762	118,615	121,203
As a percent of sales	**2.7%**	4.3%	3.3%	4.4%	5.1%
Net earnings applicable to common stock	**72,172**	116,204	85,774	118,642	121,272
Per share of common stock:					
Earnings	**$4.45**	$7.02	$5.22	$7.23	$7.42
Dividends	**$3.03**	$2.88	$2.88	$2.88	$2.64
Average common and common equivalent shares outstanding (in thousands)	**16,229**	16,562	16,429	16,406	16,344
Cash dividends paid:					
On common stock	**$ 44,345**	$ 41,930	$ 41,018	$ 40,683	$ 37,042
On preferred stock	**$ 5,985**	$ 6,701	$ 7,478	$ 7,809	$ 7,511
At Year End					
Working capital	**$ 781,333**	$ 852,847	$ 828,842	$ 785,328	$ 711,551
Property, plant and equipment, net	**401,092**	408,365	409,973	417,107	412,107
Capital expenditures:					
Company owned property	**56,023**	47,627	36,144	48,353	62,857
Capitalized leased property	**2,337**	3,431	3,966	3,940	5,860
Total assets	**1,535,241**	1,607,832	1,554,975	1,538,950	1,472,106
Long-term debt	**133,311**	139,914	193,341	198,054	187,208
Obligations under capital leases	**61,403**	69,002	73,785	76,820	79,925
Shareholders' equity	**1,064,764**	1,100,963	1,023,231	985,072	910,873
Book value per common share	**$ 70.43**	$ 68.82	$ 64.64	$ 62.36	$ 57.76

Board of Directors

Nathan S. Ancell
Chairman of the Board,
Ethan Allen Inc.

Ronald L. Aylward
Executive Vice President,
Administrative, of the Company

Zane E. Barnes
Chairman of the Board,
President and Chief Executive Officer, Southwestern Bell Corporation, and President and Chief Executive Officer of Southwestern Bell Telephone Company

Paul H. Broyhill
Chairman of the Board,
Broyhill Furniture Industries, Inc.

Stanley M. Cohen
Chairman of the Board,
Central Hardware Company

Edwin S. Jones
Retired

Donald E. Lasater
Chairman of the Board and Chief Executive Officer, Mercantile Bancorporation, Inc. and Chairman of the Board, Mercantile Trust Company National Association

Marilyn S. Lewis
Civic leader and volunteer

Thomas H. O'Leary
Vice Chairman of the Board,
Burlington Northern Inc.

John K. Riedy
Chairman of the Board
of the Company

Charles J. Rothschild, Jr.
President,
Campus Sportswear Company

Harvey Saligman
President and Chief Executive Officer of the Company

Executive Committee

Harvey Saligman, *Chairman*
Ronald L. Aylward
Donald E. Lasater
John K. Riedy

Audit Committee

Edwin S. Jones, *Chairman*
Zane E. Barnes
Donald E. Lasater
Marilyn S. Lewis
Thomas H. O'Leary

Executive Compensation and Stock Option Committee

Donald E. Lasater, *Chairman*
Zane E. Barnes
Edwin S. Jones
Thomas H. O'Leary

Nominating Committee

Zane E. Barnes, *Chairman*
Donald E. Lasater
Thomas H. O'Leary
John K. Riedy
Harvey Saligman

Corporate Officers

John K. Riedy
Chairman of the Board

Harvey Saligman
President and
Chief Executive Officer

Ronald L. Aylward
Executive Vice President,
Administrative

Eugene F. Smith
Senior Vice President,
Finance

Stanley M. Cohen
Vice President

J. Carl Powers
Vice President

Charles J. Rothschild, Jr.
Vice President

Nathan S. Ancell
Vice President

Harry M. Krogh
Vice President

Paul H. Broyhill
Vice President

Duane A. Patterson
Secretary

Robert T. Hensley, Jr.
Treasurer

Stanley F. Huck
Controller

Keith E. Mattern
General Counsel and
Assistant Secretary

James K. Pendleton
Assistant Secretary

William R. Withrow
Assistant Treasurer

Russell L. Baumann
Assistant Controller

Operating Board

John K. Riedy
Chairman of the Board of the Company

Harvey Saligman
President and Chief Executive Officer of the Company

Ronald L. Aylward
Executive Vice President, Administrative, of the Company

Eugene F. Smith
Senior Vice President, Finance, of the Company

Nathan S. Ancell
Chairman of the Board, Ethan Allen Inc.

Edwin J. Baum
President, The Biltwell Company, Inc.

Lionel Baxter
President, Big Yank Corporation

Paul H. Broyhill
Chairman of the Board, Broyhill Furniture Industries, Inc.

Stanley M. Cohen
Chairman of the Board, Central Hardware Company

Webster L. Cowden, Jr.
President, Cowden Manufacturing Company

Herschel Cravitz
President, Queen Casuals, Inc.

Barry S. Fine
President, Fine's Men's Shops, Incorporated

Jean S. Goodson
Chairman of the Board, International Hat Company

Harry M. Krogh
President, The Florsheim Shoe Company

Mark H. Lieberman
President, Londontown Corporation

Stanley Matzkin
President, Devon Apparel

Bernard Mayer
President, Idaho Department Stores Co.

Robert B. Peterson
Chairman of the Board, Sky City Stores, Inc.

J. Carl Powers
President, International Shoe Company

Charles J. Rothschild, Jr.
President, Campus Sportswear Company

Morton J. Schrader
President, Abe Schrader Corporation

Arthur Sibley
Chairman of the Board, College-Town

Irving S. Wahl
Chairman of the Board, Stuffed Shirt Inc.

Principal Companies of INTERCO

Apparel Manufacturing Group

Abe Schrader Corporation
New York, New York

Big Yank Corporation
New York, New York

The Biltwell Company, Inc.
St. Louis, Missouri

Campus Sportswear Company
Paramus, New Jersey

College-Town
Braintree, Massachusetts

Cowden Manufacturing Company
Lexington, Kentucky

Devon Apparel
Philadelphia, Pennsylvania

International Hat Company
St. Louis, Missouri

Londontown Corporation
Eldersburg, Maryland

Queen Casuals, Inc.
Philadelphia, Pennsylvania

Stuffed Shirt Inc.
New York, New York

General Retail Merchandising Group

Central Hardware Company
St. Louis, Missouri

Fine's Men's Shops, Incorporated
Norfolk, Virginia

Golde's Department Stores, Inc.
St. Louis, Missouri

Idaho Department Stores Co.
Caldwell, Idaho

Sky City Stores, Inc.
Asheville, North Carolina

United Shirt Distributors, Inc.
Detroit, Michigan

Footwear Manufacturing and Retailing Group

The Florsheim Shoe Company
Chicago, Illinois

International Shoe Company
St. Louis, Missouri

Senack Shoes, Inc.
St. Louis, Missouri

Furniture and Home Furnishings Group

Broyhill Furniture Industries, Inc.
Lenoir, North Carolina

Ethan Allen Inc.
Danbury, Connecticut

Shareholder Information

Transfer Agents

(Common and Preferred Stock)

Mercantile Trust Company
National Association
St. Louis, Missouri 63166
(314) 425-2755

Morgan Guaranty Trust Company
New York, New York 10249
(212) 587-6434

Registrars

(Common and Preferred Stock)

Centerre Trust Company
St. Louis, Missouri 63178
(314) 231-9300

Morgan Guaranty Trust Company
New York, New York 10249
(212) 587-6434

Dividend Disbursing Agent

(Common and Preferred Stock)

Mercantile Trust Company
National Association
St. Louis, Missouri 63166
(314) 425-2755

Independent Accountants

Peat, Marwick, Mitchell & Co.
St. Louis, Missouri 63101

Exchange Listings

Common and Preferred Shares and 14¼% Notes are listed on the New York Stock Exchange. Common Shares are also listed on the Midwest Stock Exchange. (Trading symbol: ISS)

Corporate Offices

Ten Broadway
St. Louis, Missouri 63102
(314) 231-1100
Mailing Address:
Post Office Box 8777
St. Louis, Missouri 63102

Annual Meeting

The Annual Meeting of Shareholders will be held at 10 a.m., Monday, June 24, 1985, at the Marriott Pavilion Hotel, St. Louis, Missouri. Notice of the meeting and a proxy statement will be sent to shareholders in a separate mailing.

INTERCO INCORPORATED
ST. LOUIS, MISSOURI